Fiscal Note 2017 Biennium

Bill #	SB0171	Title:	Generally revise taxation of income, including the corporate income tax
Primary Sponsor:	Tutvedt, Bruce	Status:	As Introduced

☐ Significant Local Gov Impact ☑ Needs to be included in HB 2 ☐ Technical Concerns

☐ Included in the Executive Budget ☐ Significant Long-Term Impacts ☐ Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2016 Difference	FY 2017 Difference	FY 2018 Difference	FY 2019 Difference
Expenditures:				
General Fund	$94,500	($486,696)	($740,820)	($753,129)
Revenue:				
General Fund	($4,609,000)	($901,000)	($142,000)	($724,000)
Net Impact-General Fund Balance:	($4,703,500)	($414,304)	$598,820	$29,129

Description of fiscal impact: This bill would restructure the individual income tax, reduce rates for the corporate income tax, and eliminate several credits. Revenue reductions would begin in FY 2016, while revenue increases from eliminating credits and cost savings would not begin until FY 2017. The general fund balance would be reduced by $4.7 million for FY 2016. In later years, the net effect would be positive in some years and negative in some years, but generally would be less than 0.05% of current-law revenue from the two taxes.

FISCAL ANALYSIS

Assumptions:

Department of Revenue

1. This bill would revise the structure of the individual income tax, reduce rates for the corporate income tax, and eliminate several credits and deductions for individuals and corporations. These changes would be effective beginning with TY 2016.
2. This bill would make federal taxable income, with a short list of adjustments, the base for the individual income tax. It would make taxable income subject to two rates, 4.8% and 6%, with separate rate tables for

taxpayers who file a joint return, who file as head of household, and who file as single or married-separate. It would require taxpayers to use the same filing status as on their federal returns. This bill also would replace the 2% capital gains credit with a 1.5% rate reduction for net capital gains.

3. The income tax forecasting model was modified to reflect the preceding provisions of the bill. The following table shows the difference between calendar year tax liability from the modified model, and the model output under current law.

Tax Liability Change by Tax Year SB 171 as Introduced	
Tax Year	**Difference in Tax Liability ($ million)**
2016	($3.76)
2017	($2.87)
2018	($3.67)
2019	($5.35)

4. Changes to the definition of taxable income and income tax rates would take effect at the beginning of TY 2016, which is the middle of FY 2016. Thus, tax liability would be reduced for half of FY 2016. The department would issue new withholding schedules in the fall of CY 2015, but it is assumed that both employers and taxpayers would take time to adjust withholding and estimated payments. Some taxpayers would end up with unplanned over-payments in the second half of FY 2016, but others would end up with unplanned under-payments. Since the net change in tax liability is about 0.3%, the net of unplanned over- and under-payments also is likely to be small. Thus, the change in revenue in the second half of FY 2016 is expected to be half the change in tax liability for TY 2016.
5. For later fiscal years, the change in revenue will equal half the change in tax liability for the tax year that overlaps the first half of the fiscal year plus half the change in tax liability for the tax year that overlaps the second half of the fiscal year. For example, the revenue change for FY 2017 will be half the change for TY 2016 plus half the change for TY 2017. The following table shows the revenue differences by fiscal year.

Revenue Change by Fiscal Year SB 171 as Introduced	
Fiscal Year	**Change ($ million)**
FY 2016	($1.88)
FY 2017	($3.32)
FY 2018	($3.27)
FY 2019	($4.51)

6. This bill would eliminate several credits and deductions that taxpayers are allowed against individual and corporate income tax. The following table shows provisions that are eliminated and the amount that each reduced revenue in the latest year for which all returns have been filed. The bill also eliminates several corporate deductions that are not reported on separate lines on the return. The impact of these deductions is unknown but is expected to be small.

Credits and Deductions Eliminated under SB 171 as Introduced ($ million)		
	Individual	**Corporate**
Empowerment Zone Credit	$0.00	$0.00
Energy Conservation Credit	$4.54	n/a
Alternative Fuel Conversion Credit	$0.01	$0.00
New and Expanded Industry Credit	n/a	$0.00
Geothermal Heating System Credit	$0.31	$0.00
Alternative Energy Production Credit	$0.00	$0.00
Mineral Exploration Credit	$0.00	$0.00
Biodiesel Production Facility Credit	$0.00	$0.00
Biodiesel Blending and Storage Credit	$0.00	$0.00
Alternative Energy System Credit	$0.63	n/a
Recycling Credit and Deduction	$0.31	$1.00
Total	**$5.81**	**$1.00**

7. Some taxpayers who claim a credit do not have enough tax liability to use the whole credit. With some credits, taxpayers are allowed to carry unused credits forward to offset tax liability in later years. For the last year of returns, credits carried forward were approximately 4.3% of individual income tax credit claims. This fiscal note assumes that the same percentage of 2015 credits will be carried forward and that two-thirds of those carry-forwards will be used to offset 2016 taxes, and one-third will be used to offset 2017 taxes.
8. The revenue impact of eliminating credits and deductions would first show up when taxpayers file their TY 2016 returns in FY 2017. In HJR 2, income tax credits are forecast as a group and corporate license tax credits are not explicitly forecast. The following table shows the revenue impacts of eliminating credits and deductions assuming that the income tax credits would grow at the rates forecast in HJ2, and that corporate credits and deductions would be constant.

Revenue Impacts of Eliminated Credits and Deductions under SB 171 as Introduced ($ million)				
	FY 2016	**FY 2017**	**FY 2018**	**FY 2019**
Individual Income Tax				
Growth from 2013 base	21.2%	27.7%	33.5%	39.2%
Eliminated Credits		$1.61	$1.94	$2.28
Pre 2016 Carry-Over		($0.20)	($0.10)	$0.00
Corporate Income Tax		$1.00	$1.00	$1.00
Total	**$0.00**	**$2.41**	**$2.84**	**$3.28**

9. Under current law, individual taxpayers are required to make a number of adjustments to federal adjusted gross income. Some of these require taxpayers to carry adjustments made in one year forward to a future year. This bill would allow taxpayers who have adjustments carried forward from previous years to use them in 2016, but not in later years. Taxpayers with net adjustments that would decrease taxable income are assumed to take advantage of this option. If this option had applied to TY 2013 returns, total taxable income would have been reduced by $2.906 million. HJR 2 assumes that these adjustments will increase by 12.7% from TY 2013 returns to TY 2016 returns. Assuming that taxpayers who use this option will be in the new top rate bracket, this transition provision will reduce tax liability on TY 2016 returns by $0.196 million. This effect will occur in FY 2017 when taxpayers file their returns for TY 2016.
10. This bill would reduce the corporate income tax rate to 6.5% for most corporations, and to 6.75% for corporations that make the water's-edge election. Tax liability was recalculated for the latest available year

of returns using the rates in this bill. Tax liability with this bill was approximately 3.67% lower. Corporations would immediately reduce their estimated payments due to the lower rates. Revenue in FY 2016 would be reduced for the second half of the year, so the reduction would be 1.835%. In later fiscal years, revenue would be reduced by 3.67%. The following table shows the revenue impacts of reduced corporate income tax rates.

Revenue Impact of Corporate Income Tax Rates, under SB 171 as Introduced ($ million)			
FY 2016	**FY 2017**	**FY 2018**	**FY 2019**
($2.73)	($5.60)	($5.52)	($5.30)

11. The following table shows the revenue impact of each component of this bill and the total.

Net Change in General Fund Revenue by Fiscal Year, SB 171 as Introduced ($ millions)				
	FY 2016	**FY 2017**	**FY 2018**	**FY 2019**
Individual Income Tax Restructuring	($1.88)	($3.32)	($3.27)	($4.51)
Eliminating Credits and Deductions	$0.00	$8.21	$8.65	$9.08
Individual Income Tax Transition		-0.196		
Corporate Income Tax Rate Change	($2.73)	($5.60)	($5.52)	($5.30)
Net Change	**($4.61)**	**($0.90)**	**$0.14**	**($0.72)**

12. Changes to tax forms and instructions would be made as part of the annual update process with no additional costs. One-time costs to have the vendor make changes to the department's data processing systems would be $94,500 in FY 2016.
13. Beginning in FY 2017, operational efficiencies would allow for reductions in FTE as described in the following table:

	FY 2016	FY 2017	FY 2018	FY 2019
Call Center Staff	--	(1.0)	(1.0)	(1.0)
Processing Staff	--	(3.0)	(3.0)	(3.0)
IT Staff	--	(1.0)	(1.0)	(1.0)
Auditing Staff	--	(3.0)	(5.0)	(5.0)
Attorney	--	--	(1.0)	(1.0)

Fiscal Impact:	**FY 2016 Difference**	**FY 2017 Difference**	**FY 2018 Difference**	**FY 2019 Difference**
Department of Revenue				
FTE	0.00	(8.00)	(11.00)	(11.00)
Expenditures:				
Personal Services	$0	($433,064)	($665,965)	($677,152)
Operating Expenses	$94,500	($53,632)	($74,855)	($75,977)
TOTAL Expenditures	$94,500	($486,696)	($740,820)	($753,129)
Funding of Expenditures:				
General Fund (01)	$94,500	($486,696)	($740,820)	($753,129)
TOTAL Funding of Exp.	$94,500	($486,696)	($740,820)	($753,129)
Revenues:				
General Fund (01)	($4,609,000)	($901,000)	($142,000)	($724,000)
TOTAL Revenues	($4,609,000)	($901,000)	($142,000)	($724,000)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	($4,703,500)	($414,304)	$598,820	$29,129

Sponsor's Initials *Date* *Budget Director's Initials* *Date*